

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Curt Hébert, Jr., Chairman;
William L. Massey, Linda Breathitt,
Pat Wood, III and Nora Mead Brownell.

Bangor Hydro-Electric Company
Central Maine Power Company
National Grid USA
Northeast Utilities Service Company
The United Illuminating Company
Vermont Electric Power Company
ISO New England Inc.

Docket No. RT01-86-000

NSTAR Services Company

Docket No. RT01-94-000

ORDER GRANTING, IN PART, AND DENYING,
IN PART, PETITION FOR DECLARATORY ORDER

(Issued July 12, 2001)

On January 16, 2001, ISO New England Inc. (ISO-NE) and a group of New England transmission owners¹ (collectively, Petitioners) filed a joint petition for a declaratory order in Docket No. RT01-86-000, seeking a determination that a hybrid transmission entity, *i.e.*, the New England Regional Transmission Organization (NERTO), satisfies the requirements set forth by the Commission in its order on Regional Transmission Organizations (RTOs).² Petitioners also seek a determination that the existing arrangements between ISO-NE, the New England TOs, and the New England Power Pool (NEPOOL) fail to satisfy the requirements of Order No. 2000, and that the Petitioners are authorized pursuant to Order No. 2000 and the Restated NEPOOL

¹Bangor Hydro-Electric Company, Central Maine Power Company, National Grid USA, Northeast Utilities Service Company, The United Illuminating Company, and the Vermont Electric Power Company (collectively, New England TOs).

²Regional Transmission Organizations, 65 Fed. Reg. 809 (January 6, 2000), FERC Stats. & Regs. ¶ 31,089 (1999) (Order No. 2000), order on reh'g, Order No. 2000-A, 65 Fed. Reg. 12,088 (March 8, 2000), FERC Stats. & Regs. ¶ 31,092 (2000), petitions for review pending sub nom., Public Utility District No. 1 of Snohomish County, Washington v. FERC, Nos. 00-1174, et al. (D.C. Cir).

Agreement (RNA) to make the necessary filings to create NERTO. Also on January 16, 2001, NSTAR Services Company (NSTAR) submitted a separate RTO compliance filing in Docket No. RT01-94-000, in which it sets forth its conditional support of NERTO.³

As discussed below, we find that NERTO would comply with some but not all of the minimum characteristics and functions set forth by the Commission in Order No. 2000. In particular, we find that NERTO's proposed scope and regional configuration would be insufficient to permit the RTO to effectively perform its required functions and to support competitive power markets. We find that at a minimum, the Northeast United States constitutes a single region that should not be divided up into multiple RTOs. In a separate order to be issued concurrently, we direct the participants in the proceedings involving the proposed Northeastern RTOs⁴ to participate in mediation on forming a single Northeastern RTO.

The Commission has been attempting to facilitate the development of large, regional transmission organizations reflecting natural markets since we issued Order No. 2000. We favor the development of one RTO for the Northeast, one RTO for the Midwest, one RTO for the Southeast and one RTO for the West. Through their independence from market participants, RTOs can ensure truly non-discriminatory transmission service and will instill confidence in the market that will support the billions of dollars of capital investment in generation and demand side projects necessary to support a robust, reliable and competitive electricity marketplace. RTOs are the platform upon which our expectations of the substantial generation cost savings to American customers are based.

While there will be "start up" costs in forming a larger RTO, over the longer term, large RTOs will foster market development, will provide increased reliability, and will result in lower wholesale electricity prices. However, these savings will be delayed,

³NSTAR, which is comprised of three operating companies (Boston Edison Company, Cambridge Electric Light Company, and Commonwealth Electric Company), is a transmission-owning utility and a member of NEPOOL. Pursuant to Order No. 2000, all transmission-owning utilities that are participants in a regional entity under Order No. 888, were required to make a filing with the Commission by January 16, 2001 explaining the extent to which the transmission entity in which it participates meets the minimum characteristics and functions outlined in Order No. 2000, or explains its efforts, obstacles or plans with respect to conforming to these standards.

⁴See PJM Interconnection, L.L.C., et al., 95 FERC ¶ 61,____ (2001) (PJM RTO Order; See also New York Independent System Operator, Inc, et al., 95 FERC ¶ 61,____ (2001); and PJM Interconnection, L.L.C. and Allegheny Power, 95 FERC ¶ 61,____ (2001).

perhaps significantly, if RTOs are permitted to develop incompatible structures and systems, or if approve RTOs that do not encompass wholesale market trading patterns. Accordingly, we today direct the parties in the Northeast and Southeast to mediation, under an expedited schedule.

With respect to other RTO characteristics and functions, we find that Petitioners only partially satisfy the Commission's requirements for RTO independence because ISO-NE would not be able to meet this standard due to its ongoing ties to NEPOOL. We cannot determine whether some of the RTO requirements, such as operational authority, tariff administration, and market monitoring, are met without further detail in the proposal. In response to Petitioners' request, we find that the existing arrangements among NEPOOL, the New England TOs, and ISO-NE do not satisfy the requirements of Order No. 2000. We also grant Petitioners' request for a declaratory order finding that Petitioners may submit the necessary filings to create an RTO.

We appreciate the time and effort invested by Petitioners in developing their proposals, especially in the area of governance structure. Because the work undertaken on these issues may be applicable to the Northeast region as a whole, we will address herein each of the RTO characteristics and functions as they apply to Petitioners' filing in order to provide guidance to the parties as they consider the formation of a single RTO for the Northeast.

Background

A. Petitioners' Filing

Petitioners state that NERTO would operate all transmission facilities currently under the control and operation of ISO-NE. These transmission facilities would include most of the facilities in the six-state New England region.

Petitioners propose a hybrid structure for NERTO, which would consist of ISO-NE, a not-for-profit independent system administrator, and the newly formed Northeast Independent Transmission Company, LLC (NE ITC), a for-profit investor-owned independent transmission company. Petitioners state that NE ITC would be given the primary responsibility for administering the New England open access transmission tariff (OATT), including the responsibility for arranging construction of new transmission facilities in the region and for generator interconnections. ISO-NE would continue to perform its existing duties as the system operator for the New England control area, would continue to administer the wholesale markets in the region, and would provide ancillary

services pursuant to a regional tariff that it would file under section 205 of the Federal Power Act.⁵ Petitioners assert that ISO-NE and NE ITC would possess, together, all of the characteristics and perform all of the functions required of RTOs. Finally, Petitioners state that under the principle of open architecture, NERTO would have the ability to evolve over time to cover a larger region.

Petitioners include in their filing a discussion of incentive pricing mechanisms for NE ITC; a Term Sheet that specifies the terms and conditions under which the New England TOs would participate in NE ITC and the various agreements that would need to be executed; a listing identifying NERTO's responsibilities and the division of these responsibilities as between ISO-NE and NE ITC, and a description of the advisory role for stakeholders with respect to NE ITC activities. Petitioners state that they have not negotiated the definitive agreements that will implement the RTO proposal, and that the Term Sheet is not legally binding and may be subject to further negotiation and change. The New England TOs, as a group, do not take a position on the relationship between ISO-NE and NEPOOL, and ISO-NE takes no position on the rate proposals outlined by the New England TOs. Petitioners state that the relationship between ISO-NE and NEPOOL would be governed by a new RTO Agreement which has also not been finalized.

Petitioners assert that their RTO proposal was the result of a collaborative process with stakeholders that included generators, marketers, merchant transmission, public power, end-users, and state commissions. Petitioners state that their filing incorporates a number of elements representing consensus developed across a broad spectrum of stakeholders.

In addition to requesting that the Commission find that their NERTO proposal satisfies Order No. 2000, Petitioners make two other requests for declaratory order. They ask that the Commission find that they have the authority to make the necessary filings to create NERTO, and that the existing arrangements among NEPOOL, the transmission owners, and ISO-NE do not satisfy the requirements of Order No. 2000.⁶

B. NSTAR's Filing

⁵16 U.S.C. § 824d (1994).

⁶As noted above, Petitioners state that those portions of their filing addressing the proposed future relationship between ISO-NE and NEPOOL and voting rights on the NEPOOL Participants Committee are sponsored by ISO-NE alone. However, Petitioners do not indicate whether their contentions regarding the existing arrangements among ISO-NE and NEPOOL are supported by both ISO-NE and the New England TOs.

NSTAR states in its filing that it participated in the negotiations giving rise to Petitioners' proposal to form NERTO, and believes that the function and operation of NE ITC could represent a marked improvement over the existing NEPOOL/ISO-NE format. NSTAR states, however, that while it supports the concept of a hybrid RTO for the New England region, the RTO must be properly structured up-front. In particular, NSTAR argues that NE ITC should be given greater responsibility within the hybrid RTO and that the Commission should address all issues relating to congestion management, cost allocation, and market monitoring at the time that it establishes NERTO.

Because these issues are also raised by Intervenors in their responsive pleadings, we will address each issue below relative to Petitioners' proposals. Accordingly, we will grant NSTAR intervention status in Docket No. RT01-86-000 and will terminate all further proceedings in Docket No. RT01-94-000.

Notices and Responsive Pleadings

Notice of Petitioners' filing was published in the Federal Register,⁷ with interventions, comments, or protests due on or before February 22, 2001. Notices of intervention and motions to intervene were submitted by the entities listed in the Appendix to this order.⁸ Protests and comments were filed by the parties noted below in the discussion section of this order and as also noted in the Appendix.

Answers to protests and answers to answers were filed by Petitioners, Municipals, HQUS, PJM Industrials, the New York Commission, Massachusetts DOER, NERPPA, Enron, Massachusetts Wholesale, NEPOOL, and NSTAR.

On February 23, 2001, Enron filed a motion to consolidate PJM's RTO filing in Docket No. RT01-2-000 with Petitioners' RTO filing herein, and to appoint a settlement judge. Responsive pleadings were filed by NECPUC, Shell, Municipals, ISO-NE, PJM, and PJM Industrials.

Notice of NSTAR's filing was published in the Federal Register,⁹ with interventions, comments, or protests due on or before February 22, 2001. Notices of intervention and motions to intervene were submitted by the entities listed in the Appendix to this order.

⁷66 Fed. Reg. 8,214 (2001).

⁸The Appendix identifies the abbreviations used throughout this order to identify Intervenors.

⁹66 Fed. Reg. 8,214 (2001).

Discussion

A. Procedural Matters

Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,¹⁰ the notices of intervention and the timely, unopposed motions to intervene submitted by the entities noted in the Appendix to this order serve to make these entities parties to this proceeding. In addition, we will accept the unopposed late-filed interventions and protests submitted by TransCanada, the Massachusetts Office of the Attorney General, Enron, the Connecticut Office of the Attorney General, and the Ontario IMO.

Rule 213(a) of the Commission's Rules of Practice and Procedure¹¹ prohibits an answer to a protest and an answer to an answer, unless otherwise permitted by the decisional authority. We will accept the answers to protests and answers to answers noted above, given the complex nature of this proceeding and because these answers aided in clarifying certain issues, as discussed below.

We will deny Enron's motion to consolidate and appoint a settlement judge. However, for the reasons discussed below, we will establish mediation procedures.

B. Hybrid RTO

Petitioners have proposed an RTO that would consist of two separate entities: ISO-NE and NE ITC. In Order No. 2000, the Commission explicitly gave transmission entities flexibility in structuring an RTO, and recognized that we would accept combination structures or even organizational forms not yet envisioned.¹² Our fundamental prerequisite for an RTO is that, whatever its structure, it satisfy the minimum characteristics and functions set forth in Order No. 2000. Accordingly, each component of a hybrid RTO that is being relied upon to satisfy any of the characteristics or functions must itself be independent from market participants.

¹⁰18 C.F.R. § 385.214 (2000).

¹¹Id. at § 385.213(a)(2).

¹²Order No. 2000 at 30,994 and 31,065.

In Commonwealth Edison Company,¹³ we said that a hybrid RTO proposal "must provide clarity about the decisional process within the RTO, accountability among the entities that constitute such an RTO, and how the binary-RTO will provide customers with 'one-stop-shopping.'"¹⁴ We also held that no organizational form would be permitted to reinstate balkanization in the markets or to deter the establishment of large regional power markets. Although we approved the general framework being proposed in that case, we withheld a decision on the specific division of functions until a detailed filing was made. These same principles apply here.

We address below the extent to which each entity within NERTO satisfies the independence characteristic, and whether the responsibilities of the two entities together satisfy all the required characteristics and functions. Although Petitioners have included an appendix to their filing that generally describes the division of responsibilities between ISO-NE and NE ITC, Petitioners have not provided the RTO Agreement or other supporting documents that would actually govern this relationship. Without these binding agreements (and the details they would be required to address), we cannot determine whether the division of responsibilities outlined by Petitioners satisfies Commonwealth Edison. Accordingly, we will reserve judgment on this aspect of Petitioners' filing.

C. RTO Characteristics

RTO Characteristic No. 1: Independence

The RTO must be independent of any market participant

1. Petitioners' Proposal

Petitioners assert that NERTO, both collectively and in its two constituent parts, would satisfy the Commission's RTO independence characteristic, because it would have (i) no financial interest in any market participant; (ii) a decision-making process that is independent of control by any market participant or class of market participants; and (iii) exclusive and independent authority under section 205 to propose rates, terms and conditions of transmission service provided over the facilities it operates. Petitioners

¹³90 FERC ¶ 61,192, reh'g. denied, 91 FERC ¶ 61,178 (2000) (Commonwealth Edison).

¹⁴Id. at 61,618.

also assert that NERTO would not operate in a vacuum, i.e., that interested stakeholders would be permitted to have input into both ISO-NE's and NE ITC's decision-making process.

a. NE ITC

Petitioners state that NE ITC would be governed by a Board comprised of three classes of Managers. Class A Managers would represent the interests of transmission owners that are also market participants; however, Class A voting rights on the NE ITC Board would be subject to the Commission's rule that individual market participants own no more than 5 percent of the RTO's voting shares, and market participants as a class own no more than 15 percent of all voting shares.¹⁵ Class B Managers, by contrast, would be independent of any transmission-owning entity or market participant. Finally, Class C Managers would represent transmission owners that are not market participants.

Petitioners' state that NE ITC would have exclusive and independent authority under section 205 to file a region-wide tariff covering transmission services other than certain ancillary services and congestion management, subject to two restrictions: first, NE ITC would be required to adhere to the Commission approved rate settlement for NEPOOL;¹⁶ and second, NE ITC would be required to design its OATT rates at levels that would permit participation fees to fully compensate participating transmission owners for the use of their transmission assets. Petitioners state that transmission owners who have not sold their transmission assets to the ITC would have section 205 rights with respect to their revenue requirements, and that NE ITC would have section 205 rights with respect to its owned assets and with respect to the service it provides over the assets it controls.

Consistent with the Commission's independence compliance audit requirements,¹⁷ Petitioners state that NE ITC would arrange for an independent compliance audit to be conducted two years after the Commission approves the RTO and every three years thereafter.

b. ISO-NE

¹⁵Order No. 2000 at 31,069-71. This rule would apply to NERTO during its first five years of operation. Id.

¹⁶New England Power Pool, 88 FERC ¶ 61,140 (1999).

¹⁷Order No. 2000 at 31,065-66.

Petitioners assert that ISO-NE currently operates independently of market participants, and that its code of conduct ensures that its employees and directors have no financial interests that could cause a conflict of interest. Petitioners state that this degree of independence would continue under NERTO.

Petitioners also assert that under NERTO, NEPOOL's role would be modified to ensure that ISO-NE has independent decision-making authority over its administration of markets and the provision of ancillary services.¹⁸ Petitioners state that in place of NEPOOL's currently effective tariff, ISO-NE would be responsible for filing a region-wide tariff for most ancillary services. In addition, ISO-NE would be authorized to propose changes to Market Rules and market related provisions of the Renegotiated NEPOOL Agreement (RNA) and to present these proposals to NEPOOL for its consideration. During the ensuing 90 days, NEPOOL would be permitted to (i) adopt the proposal; (ii) adopt a modified or alternative proposal; or (iii) determine that no change should be adopted. If NEPOOL voted to adopt a change (whether "as is" or as modified), it would then be authorized to file the proposal with the Commission under section 205. If NEPOOL voted not to adopt an ISO-NE proposal, ISO-NE would be precluded from making a NEPOOL-delegated section 205 filing. However, ISO-NE would retain its existing authority to file market rule changes under Section 6.17 of the ISO Agreement.¹⁹

Petitioners also propose to modify NEPOOL's internal governance procedures. Specifically, Petitioners propose that the vote threshold for passing a proposed Market Rule be lowered from 66.7 percent (NEPOOL's existing requirement) to 58 percent. In addition, Petitioners propose to revise NEPOOL's appellate procedures as they relate to automatic stays. Under Petitioners' proposal, NEPOOL's automatic stay allowance (which permits a single dissenting member to appeal a NEPOOL decision to the NEPOOL Review Board) would be eliminated. If NEPOOL failed to reach a decision during the 90-day period, ISO-NE would be permitted to request a vote on its proposal. The proposal would pass if it received an affirmative vote of 53 percent or more. If ISO-NE could not secure such a vote, it would not be permitted to make a NEPOOL-

¹⁸Petitioners state that ISO-NE alone sponsors that portion of its filing addressing the relationship between ISO-NE and NEPOOL and other issues, discussed below, regarding NEPOOL's internal governance.

¹⁹Sections 6.17(c) and (e) of the ISO Agreement give ISO-NE the authority to make market rule filings where an ISO-NE proposal has been denied, or where ISO-NE determines in good faith that failure to immediately implement a new or modified Market Rule would substantially and adversely affect system reliability or security, or the competitiveness or efficiency of the NEPOOL market.

delegated filing.

2. Responsive Pleadings

A number of Intervenor argue that NEPOOL impedes the efficient operation of the New England market, that NEPOOL's existing governance structure is unwieldy and dysfunctional, and that under an RTO structure, NEPOOL should be either reformed or fundamentally restructured. Several Intervenor express support for Petitioners proposed changes to NEPOOL's governance structure, while other Intervenor submit that these changes do not go far enough.

Several Intervenor propose that an independent regional market board be established to design and file market rules, and that an independent market monitoring unit be established to monitor market performance and mitigate market power abuse. Others Intervenor oppose creation of these boards. A number of Intervenor stress that an RTO for the New England region should be independent of market participants, particularly transmission owners. Intervenor are concerned that transmission owners will control NE ITC.

3. Discussion

For the reasons discussed below, we find that NERTO, collectively, under the broad outlines described by Petitioners in their filing, only partially satisfies the Commission's requirements for RTO independence. Specifically, while we are satisfied that NE ITC would operate independently from market participants, ISO-NE would not be able to meet this standard, given its ongoing ties to NEPOOL.

a. NE ITC

We find that under Petitioners' proposal, NE ITC's Managers, the entities that would operate the ITC, would perform their duties in a manner that would satisfy the independence characteristic. The holders of Class B and Class C shares would not have any ownership interest in market participants, and (with the exception of pensions and mutual fund interests that we have allowed RTOs to maintain²⁰) any financial ties to market participants. In addition, Class A Managers (who would represent members who are affiliated with market participants) would be permitted to exercise no more than 5 percent of the voting rights for any individual member and no more than 15 percent of

²⁰See Alliance Companies, et al., 94 FERC ¶ 61,070 (2001).

the voting rights as a class on the NE ITC Board. Under the rules we enunciated in Order No. 2000 for active ownership, we permit this extent of Class A voting shares.²¹ In Order No. 2000, we found that 15 percent representation for a class of market participants is a generally acceptable benchmark for class participation. Therefore, we find that the Class A Managers under Petitioners' proposal would have voting interests on the NE ITC Board that satisfy the Order No. 2000 requirements.

NE ITC would also exercise sole authority to make section 205 filings with respect to those services that would be provided under its tariff. Transmission-owners who do not sell their assets to NE ITC would be permitted to make filings to recover their revenue requirements, but would not be permitted to propose any change under section 205 to any of the terms of NE ITC's tariff.²² The proposal states that NE ITC will arrange for independent compliance audits in compliance with Order No. 2000. These audits are subject to Commission review.

b. ISO-NE

We find that under NERTO, ISO-NE would not operate with sufficient independence of market participants, given its ongoing ties to NEPOOL and the market participant interests represented within NEPOOL. While the structure and operation of ISO-NE, in other respects, satisfies the Commission's independence criteria, Petitioners'

proposal to retain much of NEPOOL's existing control over ISO-NE is inconsistent with the goals and objectives of Order No. 2000.

In order for ISO-NE to be truly independent of market participants, it must have the sole authority to make changes to Market Rules and any other changes it deems necessary without being required to seek approval from NEPOOL. Under a restructured RTO environment, market participant committees such as NEPOOL should serve a purely advisory role.

The Commission will not direct the creation of a regional market board or, as discussed below, an independent market monitoring unit, as advocated by some Intervenors.

²¹Order No. 2000 at 31,069-71.

²²Petitioners actually state that transmission owners "may not make section 205 filings to change any non-rate terms and conditions of the ITC Tariff." Petitioners' filing at 36. We assume that Petitioners did not mean to imply that transmission owners could make section 205 filings to change rate terms of the ITC Tariff, because that would violate independence principles.

We have found that, with certain changes, the Petitioners' proposal appears to meet the independence criteria required by our regulations, and we do not believe there is justification for creating another independent body to oversee the proposed RTO's activities.

RTO Characteristic No. 2: Scope and Regional Configuration

The RTO must serve an appropriate region

1. Petitioners' Position

Petitioners defend the existing scope and regional configuration of the ISO-NE control area, which they seek to adopt under NERTO. Petitioners assert that NERTO would satisfy the scope and regional configuration requirements of Order No. 2000, and that in addition, NERTO would be committed to a process that would expand its reach over the long term.

Petitioners state that their proposal satisfies the Order No. 2000 criteria for RTO scope. Petitioners state, for example, that the size of the New England control area would allow for the accurate and reliable calculation of available transmission capacity (ATC), and that because of the unique transmission topology of the New England region, parallel flows with adjacent control areas are and would be essentially non-existent. Petitioners also note that ISO-NE is committed to implementing a comprehensive, region-wide congestion management system (CMS) and multi-settlement system (MSS), and that NE ITC would be responsible for implementing new procedures for region-wide planning and expansion activities. Finally, Petitioners assert that ISO-NE is and would continue to be the security coordinator and OASIS administrator for the New England region.

2. Responsive Pleadings

Numerous Intervenors argue that ISO-NE's current scope and configuration are inefficient and inadequate and request that the Commission order the Northeast ISOs to submit an integration plan for a single Northeast RTO. Other Intervenors propose a more modest course: that ISO-NE intensify and streamline its efforts to coordinate its operations with the NYISO, PJM, and the Ontario IMO.

Enron states in its motion to appoint a settlement judge that the Northeast region should constitute a single RTO, not three. Enron asserts that a settlement judge is needed to develop milestones for achieving the various steps needed for unification of the three

Northeast ISOs. If the three RTO proposals are accepted, Enron states that they should only be accepted on condition that they unite promptly, no later than Fall 2002. Various parties filed answers and comments either in support or in opposition to Enron's protest and motion.

3. Answers

Petitioners contend in their answer that the Commission's desire to have a fully functional RTO in place by 2001 does not provide sufficient time to establish a single Northeast RTO. Additionally, Petitioners argue that requiring the formation of a single Northeast RTO could come at a substantial cost. In particular, Petitioners assert that consumers in New England and other parts of the Northeast would continue to bear the cost of any delay that might be encountered in addressing the existing inefficiencies and market failures in the New England region.

4. Discussion

In Order No. 2000, we held that an RTO must serve an appropriate region, i.e., a region of sufficient scope and configuration to permit the RTO to effectively perform its required functions and to support efficient and non-discriminatory power markets.²³ We also stated that in evaluating an RTO's proposed scope and regional configuration, we would consider, among other things, the extent to which the proposed boundaries recognize trading patterns:

Given that a goal of this initiative is to promote competition in electricity markets, regions should be configured so as to recognize trading patterns, and be capable of supporting trade over a large area, and not perpetuate unnecessary barriers between energy buyers and suppliers. There may exist today some infrastructure or institutional barriers unnecessarily inhibiting trade between regions that could be economically reduced. RTO boundaries should not perpetuate these unnecessary and uneconomic boundaries.^[24]

Applying this criteria, we note, first, that inter-regional trading among the three Northeast ISOs is significant and growing.²⁵ Indeed, to a certain extent, the Northeast ISOs

²³Order No. 2000 at 31,079.

²⁴Id. at 31,084.

²⁵The NYISO, for example, reports that energy imports of 1000 MW or greater into
(continued...)

rely on each other to meet their energy needs, whether to acquire supplies or to sell unused capacity.²⁶ The interconnected nature of this market is often reflected in the Northeast ISOs' respective market prices.²⁷ As this evidence suggests, there is a natural market which spans the Northeast region.

However, the vitality of this natural market is hampered by the balkanized set of market rules that have developed in the Northeast ISOs since their inception. These market rules vary in numerous ways, from limits placed on ramp rates for external transactions to the manner in which transmission rights are allocated and from transaction scheduling to the type of ancillary services available in the spot market. The divergence of these rules, moreover, creates uncertainty among market participants and may discourage trade in and across the Northeast ISOs.²⁸ In sum, the narrow configuration of the existing Northeast ISOs creates artificial constraints within the broader market that spans the Northeast region. In order to successfully encompass the natural market for bulk power in the Northeast, it is necessary that the Northeast transmission owners combine to form a single RTO.

We note that the Northeast ISOs have recognized the constraints placed on trade by their different market rules, and have entered into a Memorandum of Understanding (MOU), which sets forth their commitment to seek interregional coordination amongst

²⁵(...continued)

the NYISO from PJM were scheduled approximately 56 percent of the time during the year 2000. NYISO exports to New England of at least 500 MW or more were scheduled approximately 37 percent of the time, and NYISO scheduled imports from ISO-NE approximately 12 percent of the time. See NYISO, Aff. of Ricardo T. Gonzales, September Report filed in Docket No. ER00-3591-000.

²⁶The NYISO has noted that in the year 2000 it was a net importer of energy, importing energy about 97 percent of the time. In January 2000, import energy schedules from neighboring control areas exceeded 1000 MW nearly 85 percent of the time, and exceeded 2000 MW 34 percent of the time. Id.

²⁷In January 2001, for example, ISO-NE's 5-minute energy clearing price was set by external dispatchable contracts 14.6 percent of the time. See ISO-NE's January 2001 Monthly Market Report at 12.

²⁸In March 2000, for example, PJM threatened to discontinue prescheduling transactions with the NYISO due to the frequency of transaction curtailments imposed by the NYISO under its market rules.

themselves.²⁹ Pursuant to the MOU and its spirit of greater coordination, the Northeast ISOs have already taken many preliminary steps toward addressing constraints on trade, including: (i) the sponsorship of a study addressing the feasibility of implementing a combined day-ahead energy market for the Northeast; (ii) an agreement that provides for the sharing of 10 minute reserves between the NYISO and ISO-NE; (iii) an interregional congestion management redispatch mechanism that may be implemented between PJM and the NYISO; and (iv) a commitment among the Northeast ISOs to identify and implement the "best practices" followed by each.

While the MOU showed promise at the time the parties signed it, the effort has proven disappointing in implementation. The three ISOs have proceeded very slowly. Moreover, we are concerned that the MOU process does not go far enough to address seams issues in the Northeast market. This may be due to the fact that the MOU process, to date, has failed to comprehensively address the fundamental market rule differences that exist in the region. Further, as we explain in our RTO companion orders being issued today, the existing MOU, while a promising and beneficial approach to resolving regional issues, is insufficient to be considered a strong cooperative agreement with neighboring RTOs that would create a seamless trading area. The MOU initiative cannot be considered the practical equivalent of eliminating these seams, since it has not and likely would not forge a single Northeast market.

In Order No. 2000, we held that an RTO application that proposes to rely on "effective scope" to satisfy our scope requirement would be required to show that its plan would be the functional equivalent of a larger RTO.³⁰ Petitioners have not demonstrated that what they are pursuing under the MOU, even were it to be achieved, would be the functional equivalent of a single Northeast RTO.

In the PJM RTO Order, we conclude that PJM's proposed scope and regional configuration represents a platform that can and should be expanded upon. We also encourage the three existing Northeast ISOs to look at the best practices in all three ISOs and to adopt those market rules that would be appropriate for a single Northeast RTO. Consistent with this ruling, and in consideration of the above, we are issuing concurrent with this order, a separate order that directs the parties in this proceeding and the parties in Docket Nos. RT01-2-000 (PJM), RT01-95-000 (New York) and RT01-98-000 and RT01-10-000 (PJM West), to participate in settlement discussions for 45 days before a mediator and appropriate consultants to assist and provide advice

²⁹The MOU was executed by ISO-NE, the NYISO and PJM in August 1999. The Ontario IMO joined the MOU later in 1999.

³⁰Order No. 2000 at 31,083.

during the mediation.³¹ The order directing mediation requires the mediator to file a report within 10 days after the 45 day period, which includes an outline of the proposal to create a single Northeastern RTO, milestones for completion of intermediate steps and a deadline for submitting the joint proposal. We intend to review the report and may issue a subsequent order.

We encourage the state commissions to participate in these efforts. We believe their participation will further the resolution of this matter. Similarly, we encourage Canadian entities that are part of the Northeast Power Coordinating Council to participate in the discussions to the extent consistent with their status as subjects of a foreign sovereign nation.

RTO Characteristic No. 3: Operational Authority

The RTO must have operational authority for all transmission under its control.

1. Petitioners' Proposal

Petitioners state that NERTO will have operational authority for all transmission facilities under its control and that the ISO-NE will have the lead responsibility for the operational control of the bulk power system. Petitioners assert that ISO-NE currently performs the following functions per Order No. 2000: security analysis, interregional coordination, real-time monitoring of system conditions, general dispatch, control area interchange and interchange scheduling, transmission operations, and curtailment actions. Petitioners state that NE ITC -- through existing control area satellites -- will physically perform real-time monitoring of system conditions to include switching of transmission facilities, monitoring and controlling real and reactive power flows, monitoring and controlling voltage levels, and scheduling and operating reactive levels. Petitioners also state that NE ITC will also develop procedures, guidelines, schedules, and/or standards to support the ISO-NE operational authority, as appropriate.

In addition, Petitioners state that ISO-NE is currently the security coordinator for the New England region. Under the Petitioners' proposal, ISO-NE will remain the security coordinator and continue to have responsibility for: (i) performing load-flow, stability, and other studies as may be required; (ii) exchanging security information with local and regional entities; (iii) monitoring real-time operating characteristics such as availability of reserves, actual power flows, interchange schedules, system frequency and generation adequacy; and (iv) directing actions to maintain reliability, including firm load shedding.

³¹See order issued concurrently in Docket No. RT01-99-000.

2. Responsive Pleadings

Several Intervenors question the proposed division of authority between ISO-NE and NE ITC. Intervenors also note that the basis for the allocation and the interrelation between ISO-NE and NE ITC is not sufficiently clear to allow for detailed comment. Shell raises concerns that the bifurcated decision making between the non-profit ISO-NE and the for-profit NE ITC will strain the independence of Petitioners' proposed RTO.

3. Discussion

In Order No. 2000, we held that an RTO must have operational authority for all transmission facilities under its control and must also be the security coordinator for its region.³² No party disputes Petitioners' compliance with this requirement with respect to NERTO as a collective entity. However, Intervenors do challenge the proposed division of duties and functions as between ISO-NE and NE ITC, including in particular which of these entities should be responsible for overseeing the RTO's interconnection procedures. Several Intervenors argue that ISO-NE, not NE ITC, should be responsible for these responsibilities.

In Order No. 2000, we held that those designing the RTO should have flexibility to decide how the RTO would exercise its operational control authority, and that we would leave it to the discretion of the region to decide on the particular allocation of authority that works best.³³ The standard applied by the Commission in reviewing any proposed allocation of control, we said, would be whether the chosen allocation ensures reliable operation of the grid and non-discriminatory access to the grid by all market participants.

While Intervenors challenge the specific division of duties and functions outlined in Petitioners' filing, they have not supported their contention that this proposed division would lead to the unreliable or discriminatory operation of the New England market.³⁴ The Commission must ensure that a hybrid proposal "must provide clarity about the decisional process, accountability among the entities that constitute such an RTO, and how the binary-

³²Id. at 31,090.

³³Id. at 31,091.

³⁴As we note above, however, other factors (including the optimal scope and regional configuration of the region) could have a bearing on reliable operation of the region as a whole.

RTO will provide customers with 'one-stop-shopping.'"³⁵ Until we have the proposed agreements and tariff language before us that would specify the nature and extent of these duties under a hybrid RTO, we cannot conclude that Petitioners proposal, in the form it currently exists, meets the operational authority criteria of Order No. 2000.

RTO Characteristic No. 4: Short-Term Reliability

The RTO must have exclusive authority for maintaining the short-term reliability of the grid that it operates.

1. Petitioners Proposal

Petitioners state that under NERTO, ISO-NE would continue to exercise exclusive authority for maintaining short-term reliability of the New England transmission grid. Specifically, ISO-NE would continue to: (i) receive, confirm, and implement all interchange schedules, and coordinating these interchange schedules with neighboring control areas; (ii) issue redispatch orders; (iii) approve any portion of a transmission maintenance schedule to ensure that transmission outages can be accommodated within established reliability standards; and (iv) approve generation maintenance schedules. Additionally, Petitioners state that ISO-NE and NE ITC would be responsible for their respective obligations for transmission and operations compliance with the North American Electric Reliability Council (NERC) and the Northeast Power Coordinating Council (NPCC) standards, and for establishing standards for determining facility ratings. Finally, Petitioners state that NE ITC would be responsible for developing long-term and short-term transmission outage schedules in coordination with affected generators and for including performance standards in their rate schedules.

2. Responsive Pleadings

Williams argues that the division of authority over reliability matters between ISO-NE and NE ITC must be clarified. American Forest seeks clarification that ISO-NE's redispatch authority would only apply to generation "in the pool" and would be inapplicable to self-supplied, on-site customer-owned generation.

3. Discussion

To discharge their short-term reliability duties, Order No. 2000 requires RTOs to have exclusive authority for: (i) receiving, confirming and implementing all interchange schedules; (ii) redispatching generators; and (iii) overseeing all requests for scheduled

³⁵Commonwealth Edison at 61,618.

outages of transmission facilities.³⁶ We find that Petitioners' proposal generally meets this criteria, subject to our finding above, regarding the optimum scope and regional configuration of the RTO. With respect to American Forest's concerns, we hereby clarify that ISO-NE's redispatch authority under NERTO should be consistent with its interconnection agreements on file with the Commission. With respect to Williams' concerns, greater clarification of the roles of ISO-NE and NE ITC in maintaining reliability will be detailed when specific tariff language is filed for a single Northeast RTO.

D. RTO Functions

RTO Function No. 1: Tariff Administration and Design

The RTO must administer its own transmission tariff and employ a transmission pricing system that will promote efficient use and expansion of transmission and generation facilities.

1. Petitioners' Proposal

Petitioners propose that NE ITC would be the sole provider of transmission service over the facilities under its control, and the sole administrator of its open access tariff, which it would design and administer. NE ITC would have the sole authority to receive, evaluate and approve requests for transmission service and new interconnections, with the exception of short-term firm and non-firm transmission service requests which ISO-NE would process via OASIS.³⁷ In addition, Petitioners propose to give NE ITC sole authority to file rates for transmission service under NE ITC Tariff and the exclusive authority to seek changes to the rates, terms and conditions of the transmission services offered. They also provide that NE ITC would develop regional interconnection procedures and file a pro forma interconnection agreement. Petitioners submit that transmission customers would not pay multiple access charges for service across the same facilities under its tariff.

In addition, transmission owners who transfer operating control of their transmission assets to Petitioners would be compensated under the terms of a participation agreement between the transmission owners and NE ITC. Petitioners further state that,

³⁶Order No. 2000 at 31,104.

³⁷ISO-NE would have primary responsibility for the reservation and scheduling processes for transmission service on OASIS and most ancillary services would be provided under ISO-NE tariff.

other than through NE ITC's governance process, transmission owners would have no authority with respect to establishing NE ITC's rates or tariff design.

2. Responsive Pleadings

Several Intervenors oppose Petitioners' proposal to continue charging separate rates for transmission service provided over non-pool transmission facilities³⁸ (non-PTFs). These Intervenors view the two-tiered rate structure as anti-competitive, unduly discriminatory and inconsistent with Order No. 2000. NERPPA states that generation facilities located on PTF have a competitive advantage over generators connected to non-PTF. Vermont Utilities claims that these pancaked rates could cause customers to pay three separate charges for service across its service territory. Enron protests the rate distinction as no longer necessary due to a viable retail market and the transmission owners' increased control over the tariff. NERPPA and Vermont Utilities state that eliminating the rate distinction for generators interconnected to non-PTF³⁹ would not conflict with the NEPOOL settlement. Vermont Utilities recommends that NE ITC continue its transition to postage stamp pricing.

Calpine further notes that transmission agreements in New England are offered at substantially different rates and advocates a uniform approach for transmission pricing. Vermont Utilities also requests that NE ITC Tariff include the Highgate Converter and Phase I/Phase II High Voltage Direct Current (HVDC) facilities.⁴⁰ HQUS states that

³⁸NERPPA explains that transmission service over a pool transmission facility (PTF) is governed by the NEPOOL OATT while transmission service over a non-PTF is governed is governed by each transmission owner's OATT. The proposal would provide transmission service under one conformed ITC tariff, but maintain the rate distinctions so that generators interconnected to non-PTF would pay substantial wheeling charges to reach load outside of their respective utility's franchise territories. See NERPPA Protest at 5.

³⁹Several Intervenors also recommend directing Petitioners to eliminate the rate distinction due to insufficient detail and failure to justify the rate distinction. Other Intervenors protest the proposed tariff as premature for review and a few suggest appointing a settlement judge to direct the design of the RTO tariff.

⁴⁰According to Vermont Utilities, the Phase I/Phase II HVDC facilities are DC lines between Quebec and Massachusetts and the Highgate Converter is a 225 MW Alternating Current (AC)-DC converter that interconnects the New England grid with the transmission facilities of Hydro-Quebec and associated AC facilities. Vermont Utilities requests inclusion of these facilities in NE ITC tariff so that all loads in New England bear
(continued...)

with respect to ties between Quebec and the United States, emphasis must be given to strengthening the transfer capability of the interconnections in order to maximize the level of cross border energy flows. HQUS further states that this would require enhancing the internal transmission system in New England and the Northeast, rather than enhancing the 450 kV HVDC line.

A number of Intervenor protest giving NE ITC exclusive authority over requests for transmission service and new interconnection service.⁴¹ Many of these Intervenor express concern that transmission owners would influence decisions regarding new interconnection service and transmission service and recommend that the ISO Board have final approval over interconnections. For the same reason, PG&E, et al. and Consumers state that the authority to file a standard interconnection agreement should rest with ISO-NE or another independent entity. However, Williams comments that it would support NE ITC's sole authority over such requests if the Commission adopts a nationwide, uniform interconnection policy for all RTOs. Calpine contends that each utility sets its own interconnection policy despite the Commission's directive to create a "one-stop shopping" interconnection process administered by ISO-NE. Calpine claims that giving NE ITC "unfettered control" over interconnection policy would perpetuate the wide disparity of interconnection agreements in New England, and recommends that an independent body review all existing service agreements, upon the customer's request. In addition, Dynegy requests a generic proceeding on interconnections.

3. Answers

With respect to some Intervenor's concern regarding PTF/non-PTF rate structures, Petitioners state that their filing did not propose any specific treatment of the non-PTF, other than stating its agreement to comply with the NEPOOL settlement through 2003. Petitioners state that the Commission has previously found it acceptable for transmission owners to maintain separate tariffs for service on non-PTF facilities in New England, and did not violate Order No. 888's proscription against rate pancaking. Petitioners note that they are still discussing various options for the treatment of non-PTF, such as the rolling in

⁴⁰(...continued)

proportionate responsibility for the costs of these facilities because under the current pricing methodology, all New England customers benefit from the power that these facilities import.

⁴¹Municipals contests ISO-NE's authority to assign its "core obligation" of administering transmission and market arrangements pursuant to the NEPOOL OATT and claims that the existing ISO-NE/NEPOOL structure meets this required RTO function. See supra section G.

of non-PTF into NE ITC tariff. Petitioners contend that Intervenor arguments regarding treatment of non-PTF are premature because there is no specific proposal before the Commission on this issue. Petitioners propose to address this issue in NE ITC tariff filing. Finally, Petitioners note that due to their lack of a request for approval of tariff or pricing proposals, a hearing and appointment of a settlement judge is premature.

4. Discussion

In Order No. 2000, the Commission held that an RTO tariff must not result in transmission customers paying multiple access charges for the recovery of capital costs for transmission service over facilities that the RTO controls, *i.e.*, pancaked rates.⁴² Petitioners propose to maintain the multiple access charges for PTF and non-PTF,⁴³ and assert that this is not rate pancaking. In addition, Petitioners suggest that eliminating the rate distinction would violate NEPOOL's rate settlement agreement.⁴⁴ Under Petitioners' proposal, access to both PTF and non-PTF would be subject to the terms of the single NE ITC Tariff, but the different rates for PTF and non-PTF would remain. They assert that their NE ITC tariff would provide one-stop shopping for transmission in New England unlike the dual tariff PTF/non-PTF arrangement that is currently in place.

Because the PTF/non-PTF situation presents complicated tariff and pricing issues, and because we do not have a specific tariff proposal before us, we will not at this time make any findings on the PTF/non-PTF pricing issue. We encourage Petitioners to continue discussing these issues with their stakeholders. We note that in Order No. 2000 and subsequent cases, we concluded that we would continue to provide flexibility with

⁴²Order No. 2000 at 31,174.

⁴³PTFs comprise about 65 percent of the transmission facilities in NEPOOL and include those transmission facilities rated 69 kV or above that are required for energy from significant power sources to move freely on the New England grid. However, transmission facilities rated 69 kV or above are not included in PTF facilities if they are needed to serve local loads. Generator leads and facilities that interconnect non-PTF facilities to PTF facilities are also not included in PTF.

⁴⁴The Commission approved NEPOOL's proposed partial settlement, which provided for the filing of a tariff that contained postage stamp rates for PTF and local rates for service provided on non-PTF. 88 FERC at 61,436. *See also*, New England Power Pool, 89 FERC ¶ 61,292 (1999). Petitioners commit to preserving the currently effective transition mechanisms in the NEPOOL Tariff at least through 2003, consistent with the rate settlement.

respect to RTO proposals for allocation of fixed transmission cost recovery, and permitted, for example, the use of license plate rates for a transitional period.⁴⁵

With respect to Calpine's complaint that excepted transactions are offered at substantially different rates, we note NEPOOL's excepted transactions are grandfathered agreements that existed prior to the inception of the NEPOOL OATT.⁴⁶ In New England Power Pool,⁴⁷ we declined to order all self-designated excepted transactions⁴⁸ to convert to service under the NEPOOL OATT. We accepted NEPOOL's proposal as consistent with Order No. 888, in which the Commission chose not to order generic abrogation of existing requirements and transmission contracts.⁴⁹ Subsequently, in Order No. 2000, we did not require the generic abrogation of existing requirements and transmission contracts,⁵⁰ and we will not do so here.

A number of Intervenor's express concern over the transmission owners' influence in the transmission and generator interconnection process and submit that the New England TOs would favor their own financial interests and create barriers to competition in the region. Given our ruling, above, regarding NE ITC's independence under NERTO, we find that Intervenor's concerns regarding NE ITC's lack of independence in connection with the transmission and interconnection request process to be unfounded.⁵¹ However, until Petitioners propose specific tariff language explaining this process in greater detail, we cannot conclude that the tariff administration and design proposal

⁴⁵Order No. 2000 at 31,177.

⁴⁶See, New England Power Pool, 83 FERC ¶ 61,045 (1998).

⁴⁷Id. at 61,242.

⁴⁸Excepted Transactions are power transfers and other uses of the NEPOOL Transmission System under transmission agreements in effect on or before November 1, 1996. Excepted transactions concerning Pool-Planned Units, certain nuclear units and Hydro-Quebec purchases would be converted to the NEPOOL Tariff. New England Power Pool, Id. (citing Section 25 of the NEPOOL OATT).

⁴⁹Id. at 61,242, n. 92, citing Order No. 888, FERC Stats. & Regs., Regulations Preambles January 1991-June 1996, ¶ 31-036 at 31,663-65.

⁵⁰Order No. 2000 at 31,205.

⁵¹This is not the appropriate proceeding to address Intervenor's requests for a nationwide uniform interconnection policy.

outlined by Petitioners satisfies Order No. 2000. Additionally, the Commission intends in the near future to evaluate the importance of standardized interconnection procedures.

With respect to Vermont Utilities' request that the Phase I/Phase II HVDC facilities and the Highgate Converter be included in NE ITC's Tariff, we addressed a similar issue in TransEnergie U.S. Ltd.⁵² TransEnergie, a merchant/transmission owner, proposed to build an under sea high voltage DC transmission line between Connecticut and Long Island, New York. TransEnergie committed to cooperate with the development of the RTO and give operational control of the transmission line to the RTO. Therefore, we encourage Petitioners to address the issue of incorporating the Phase I/Phase II HVDC facilities and the Highgate Converter into the new tariff that would need to be filed as part of the proposal to form a single Northeast RTO.

Regarding Vermont Utilities' request for rolled-in treatment of these facilities, as Petitioners have not submitted a specific pricing proposal, this rate issue is premature for review.

RTO Function No. 2: Congestion Management

The RTO must ensure the development and operation of market mechanisms to manage transmission congestion. The RTO must satisfy the market mechanism requirement no later than one year after it commences initial operation. However, it must have in place at the time of initial operation an effective protocol for managing congestion.

1. Petitioners' Proposal

Petitioners propose to meet this requirement through the market mechanism of the CMS already being implemented by ISO-NE. Petitioners explain that ISO-NE would implement the CMS approved by the Commission⁵³ within the time frames required by Order No. 2000. Petitioners state that NEPOOL and ISO-NE have been making the required compliance filings and are developing Market Rule changes on an expedited basis to implement the CMS. In addition, Petitioners assert that the CMS market mechanisms would accommodate the broad participation of all market participants, and provide all transmission customers with efficient price signals.

2. Responsive Pleadings

⁵²91 FERC ¶ 61,230 (2000).

⁵³ISO New England, Inc., et al., 91 FERC ¶ 61,311 (2000) (CMS/MSS Order); order on compliance, 93 FERC ¶ 61,290 (2000); order on reh'g, 94 FERC ¶ 61,237 (2001), order on reh'g, 95 FERC ¶ 61,174 (2001).

Several Intervenor criticize the adoption of the location marginal pricing (LMP) model to manage transmission congestion in New England. NERPPA contends the "anti-competitive effect" of nodal pricing, *i.e.*, LMP, would threaten both existing and newly developing renewable generation. NERPPA notes that New England's renewable generators are located close to their fuel source (*e.g.*, biomass plants are located in or near forests); and outside of load-pockets, *i.e.*, in areas where the nodal price for power will tend to be comparatively low. NERPPA states that the differential between the nodal price in a load pocket and the nodal price where renewable generators are located will make it more difficult for renewable generators to compete.⁵⁴ Other Intervenor

state that the LMP system involves undue complexity, lack of price certainty, high cost and low liquidity in the forward market, and blocks access to new entrants. Dynegy states that the Commission is willing to accept other approaches besides the LMP system.

Despite its concerns with the LMP system, Enron states that given the Commission's acceptance of the existing and proposed CMSs in the Northeast, the sensible approach to regional market formation is to condition acceptance of the RTO compliance filings on their joint adoption, as a single RTO, of the PJM CMS.⁵⁵ Enron argues that the different CMSs of the three Northeast ISOs are inconsistent and undermine each system's effectiveness. NICC notes that CMS/MSS implementation is delayed well beyond market participants' and the Commission's initial expectations, and also advocates adopting PJM's CMS.

Municipals claim that the Commission's congestion management requirements are met by NEPOOL's CMS and are already being implemented by ISO-NE, but acknowledge that CMS alone would not ensure the timely siting and construction of resources and other facilities needed to relieve localized congestion. NSTAR disagrees with Petitioners' proposal to divide responsibility for short-term congestion management between NE ITC and ISO-NE. NSTAR believes the responsibility should lie solely with NE ITC, which has the economic incentive to lower the delivered cost of electricity. They argue that the inability to assess the causes of congestion charges significantly blocks the development of effective mechanisms for encouraging new transmission construction. Municipals further complain about the lack of discussion regarding how congestion volumes would be reduced

⁵⁴ Additionally, NERPPA asserts that for some technologies, nodal pricing would virtually assure that they would not be commercially viable even though those facilities' production costs are less than fossil plants located within the load pocket.

⁵⁵ Enron recommends that certain aspects of PJM's LMP not be adopted. See Enron Protest at 9.

once NE ITC is formed and the cost reductions resulting from transmission congestion management.

3. Answers

In response to Intervenor's suggestion that Petitioners adopt their preferred CMS systems, Petitioners state that efforts to relitigate issues decided nearly a year ago should not be considered in this proceeding, and contend that this docket is not the appropriate forum to pursue a rehearing of the CMS/MSS Order. They further state that the formation of a NE ITC would address the Municipals' concern with relieving congestion.

4. Discussion

In Order No. 2000, we held that an RTO must ensure the development and operation of market mechanisms to manage transmission congestion.⁵⁶ Petitioners state that the congestion management function required for an RTO under Order No. 2000 would be met by ISO-NE pursuant to the CMS procedures currently pending before the Commission. Consistent with our ruling above regarding NERTO's scope and regional configuration, however, we find that Petitioners' approach to congestion management, while provisionally consistent with Order No. 2000, represents only a first step that must be built upon. Varying congestion management systems within a natural regional energy market such as the greater Northeast can operate as a barrier to entry to new market participants. This is why it is critical for the market participants in the greater Northeast to reach agreement on market rules.

With respect to NERPPA's contention that LMP thwarts the development of renewable resources, we disagree.⁵⁷ In Order No. 2000, the Commission stated that

⁵⁶Order No. 2000 at 31,108.

⁵⁷We note that in the CMS/MSS Order, NERPPA based a request for exemption from congestion costs on the same claim of LMP's anti-competitive effect on renewable generators. We denied NERPPA's request, finding that exempting renewable generators from congestion charges would place them at an advantage over other generators. We reasoned that LMP is designed to send appropriate price signals for energy and transmission, and congestion charges are only one component of the price methodology.

(continued...)

markets based on locational marginal pricing and financial rights for firm transmission service appear to provide a sound framework for efficient congestion management.⁵⁸

As to Municipals' argument that CMS alone would not ensure the construction of facilities needed to relieve localized congestion, we agree. As we note in the PJM RTO Order, the use of the LMP model indicates areas where expansion of the transmission system or construction of generation facilities may be needed to reduce congestion costs. LMP does not guarantee that facilities will be built.

RTO Function No. 3: Parallel Path Flow

The RTO must develop and implement procedures to address parallel path flow issues within its region and with other regions. The RTO must satisfy this requirement with respect to coordination with other regions no later than three years after it commences initial operation.

1. Petitioners' Proposal

ISO-NE would be responsible for managing parallel path flows. Currently the NEPOOL Tariff addresses internal parallel path flows through redispatch on a least cost basis. Under the proposal, internal parallel path flows would be addressed by (i) the CMS that would use locational prices for energy and financial congestion rights, and (ii) embedded cost compensation and rate design issues that would be addressed by NE ITC. In addition, ISO-NE would use its own reliability procedures and CMS to address parallel path flows issues internal to New England and over the New York interface, and would continue to subscribe to the NERC transmission loading relief (TLR) procedure.

Petitioners state that there are no external parallel path flows because all the current interconnections with the Canadian regions are DC ties, except for a single AC tie, and the only other interconnection is with New York, which is treated as a single interconnection. To the extent additional measures are needed, Petitioners propose to implement them within three years of initial operation.

⁵⁷(...continued)

Consistent with our determination in the CMS/MSS Order, we reject NERPPA's argument that LMP would place renewable energy resources at a greater disadvantage than fossil-fired generation facilities. See also New England Power Pool, 95 FERC ¶ 61,384 (2001).

⁵⁸Order No. 2000 at 31,127.

2. Responsive Pleadings

Municipals state that the RTO proposal adds nothing new to the current procedures. Noting that ISO-NE currently has procedures to address internal parallel path flows, Williams advocates establishing a single Northeast RTO to solve external parallel flows. Enron identifies typical market transactions as the cause of significant unintended parallel flows throughout the Northeast ISO regions. Enron claims that these parallel flows can be solved by creating a single Northeast RTO instead of the three separate Northeast tight power pools, which Enron contends fail to internalize the parallel flows. Several Intervenors oppose Enron's comments relating to parallel flows. Municipals disagree with Enron's stance on consolidating the three Northeast ISOs and challenge the validity of Enron's assertions. Municipals question Enron's assertion that flows are uncontrolled and causing regional problems and challenge Enron's claim that the three existing power pools have not individually managed power flows among the control areas.

3. Answers

Contrary to Enron's assertions, ISO-NE claims that changing the boundaries of an RTO will not reduce parallel flows or parallel flow impacts since contract path scheduling practices have been identified as the primary source of parallel flow problems in Eastern Interconnections.⁵⁹ ISO-NE states that NERC and NPCC have identified flow-based scheduling as the best industry solution to contract-path scheduling, parallel path flows and supports NERC's project to implement flow-based scheduling.

4. Discussion

Order No. 2000 requires that the RTO develop and implement procedures to address parallel path flows within its region immediately and within three years after it commences initial operation with other regions.⁶⁰ Although ISO-NE currently manages parallel flows internal to the New England region, Petitioners continue to rely on arguments made in previous ISO-NE filings that there are no parallel flows of concern outside of NEPOOL, which we rejected in the CMS/MSS Order. Petitioners have not addressed how parallel flows would be internalized within the Northeast region and neighboring regions, and therefore have not satisfied this function. We expect parallel path flows to be addressed comprehensively by the larger scope of a northeastern RTO. The issue of flow problems

⁵⁹See Answer of ISO-NE at 9.

⁶⁰Order No. 2000 at 31,130.

caused by differing contract rights should be resolved so that scheduling can be done efficiently.

RTO Function No. 4: Ancillary Services

The RTO must serve as a provider of last resort of all ancillary services required by Order No. 888 and subsequent orders.

1. Petitioners' Proposal

Petitioners state that ISO-NE would continue to administer the ancillary service markets⁶¹ and be the provider of last resort for the generation-related ancillary services required by Order No. 888. The ancillary services would be provided under the ISO tariff, which would include ISO-NE's determination of the amount of ancillary services required, and if necessary, the locations at which these services must be provided.

In addition, Petitioners submit that purchases of reactive power would be ordered through the ISO control room on an hourly basis, and spot purchases of reactive support from generators would be overseen under a mechanism to be developed by ISO-NE under the ISO tariff. Transmission-based reactive support would be provided under NE ITC tariff and passed through by ISO-NE to transmission customers without an ISO-NE markup. Petitioners propose that both ISO-NE and NE ITC would support the scheduling and dispatch ancillary service, and would be covered under ISO-NE Tariff and NE ITC tariff, respectively. In addition, Petitioners propose that ISO-NE and NE ITC would jointly develop the system restoration plan. Under the proposal, ISO-NE would approve the plan and NE ITC would procure the services and provide them under the ITC tariff. Petitioners further explain that, together with NEPOOL, they are addressing the requirement that all market participants have the option of self-supplying or acquiring ancillary services from third parties. According to Petitioners, self-supply of AGC is not technically feasible.

2. Responsive Pleadings

Enron protests the proposal's failure to allow market participants to self-supply ancillary services which it claims ultimately prevents the development of a vigorous forward market in New England. Enron states that currently load serving entities (LSE)

⁶¹ISO-NE operates four ancillary service spot markets: (i) automatic generation control (AGC); (ii) ten-minute spinning reserve (TMSR); (iii) ten-minute non-spinning reserve (TMNSR); and (iv) thirty-minute operating reserve (TMOR).

must purchase reserves from the NEPOOL spot markets at prices that are determined after-the-fact. Enron further claims that the absence of a forward market for reserves makes it difficult for LSE to provide fixed-price load following service to customers without a substantial reserves risk premium, and produces market inefficiency. Enron asserts that a forward market provides mechanisms and incentives to stabilize prices and prevent monopsony purchasers of scarce resources from gaining market power.

Williams also endorses allowing market participants to self-supply or acquire ancillary services from third parties. Williams further protests Petitioners' proposal for ancillary services as being unnecessarily complicated. Although Williams acknowledges that the proposal did not specifically address this issue, Williams objects to a continuation of the practice of generators entering into long term contracts with other generators for ancillary services at little or no cost. Municipals state that the proposed changes do not reflect the perceived deficiencies in the current structure, and cite to Petitioners' acknowledgment that the ancillary service requirements are already being met by ISO-NE.⁶² Municipals also expresses their concern with the "inherent conflicts" in the ISO's role as a market participant and a monitor.

NICC states that dramatic increases in electricity costs in New England for retail customers result from the dysfunctional New England installed capability, energy, and ancillary service markets, and are undermining various states' retail access initiatives. PG&E et al state that if the proposed ITC's transmission tariff enhances the transmission owners' interest in market outcomes, then providing reactive supply and voltage control from generation sources (VAR support) cannot be part of ITC's tariff, because it represents an increase in the ITC's vertical market power.

3. Answers

Petitioners agree with Enron's comments that market participants must be able to self-supply ancillary services, but disagree with Williams' assertion that their approach to supply of ancillary services is "overly complicated;" rather it reflects the separation of the market/dispatch functions and tariff (entrusted to ISO-NE) from transmission operation and tariff (entrusted to NE ITC). Petitioners also rebut Municipals' claim that "inherent conflicts" exist in ISO-NE's dual role as both ancillary services "market participant" and monitor. They state that the true providers of these services (and therefore, the true market participants) are the bidders, and ISO-NE has no conflict of interest as a market monitor as it currently earns no profit or markup on the sales made by the participants in these markets.

⁶²See Municipal's Protest at 85.

4. Discussion

In Order No. 2000, we found that an RTO must serve as the provider of last resort for ancillary services, and all market participants must continue to have the option of self-supplying or acquiring ancillary services from third-parties.⁶³ We also determined that the RTO must have the authority to decide the minimum amounts of each ancillary service and, if necessary, the locations at which these services must be provided.⁶⁴ ISO-NE, as proposed, would be the provider of last resort for ancillary services. Additionally, ISO-NE would have the authority to decide the minimum required amounts of ancillary services and the locations at which the services must be provided. Currently, ISO-NE does not meet the requirement of permitting market participants to self-supply ancillary services, as required in the CMS/MSS Order and Order No. 2000. In order to meet the ancillary services criteria of Order No. 2000, the RTO must allow market participants to self-supply those ancillary services to the extent possible.

RTO Function No. 5: OASIS, Total Transmission Capability (TTC) and ATC

The RTO must be the single OASIS site administrator for all transmission facilities under its control and independently calculate TTC and ATC.

1. Petitioners' Proposal

Petitioners propose that ISO-NE would continue as the single OASIS site administrator for all transmission facilities under NE ITC Tariff. In addition, ISO-NE would continue to calculate ATC for the posted interfaces under the NEPOOL and Maine Electric Power Company Tariffs, and short-term values for TTC for the posted interfaces, and for all of the inter-control area interfaces. Petitioners also propose that NE ITC would calculate long-term TTC for the posted interfaces, include such calculations in the regional transmission plan, and support ISO-NE in its other OASIS-related calculations. In addition, a joint committee of NE ITC and ISO-NE would conduct inter-control area transfer capability limitations and jointly develop procedures for determining ATC, TTC, transmission reliability margin and capacity benefit margin within NPCC and NERC guidelines. In the event of a dispute with an RTO customer over ATC values, Petitioners state that the RTO's values would be used pending the outcome of the dispute resolution process. Petitioners also provide that ISO-NE would continue to post relevant data such as ATC indices on ISO-NE website, and would assess posting other data and indicators to validate its ATC values under the proposed RTO structure.

⁶³Order No. 2000 at 31,140.

⁶⁴Id. at 31,141.

2. Responsive Pleadings

Several Intervenor object to the proposed allocation of responsibility to NE ITC to assist in this RTO function. Contending that the proposed shared approach of calculating ATC and TTC has the potential to create as many problems as it resolves, Williams suggests that ISO-NE independently perform these calculations, subject to confirmation by NE ITC. EPSA protests allowing NE ITC to calculate long-term TTC for transmission interfaces posted on Petitioners' OASIS site (and for all inter-control-area interfaces) which it claims raises a strong potential for conflict of interest because NE ITC would also seek financial incentives arising from its performance in managing TTC. Similarly, PG&E et al states that if the proposed ITC transmission tariff enhances the transmission owners' interest in market outcomes, then the calculation of TTC and ATC cannot be part of NE ITC's function and tariff because this function is amenable to the exercise of NE ITC's vertical market power. In addition, Dynegy requests the posting of information relating to an RTO's interconnection requirements and the status of interconnection requests on the RTO's OASIS.

3. Answers

In response to Intervenor's objections to the proposed allocation of responsibilities, Petitioners state that this proposal resulted from extensive negotiations and stakeholder input. They claim that it is appropriate for NE ITC to participate in the determination of TTC and ATC since it is responsible for the operation of the relevant transmission facilities. In addition, Petitioners state that NE ITC, as a for-profit-entity, can be given appropriate incentives through transmission rates to optimize its determination of the transfer capability of its facilities and that NE ITC and ISO-NE would satisfy the independence requirements applicable to RTOs.

4. Discussion

In Order No. 2000, we held that an RTO must be the single OASIS site administrator for all transmission facilities under its control, and must calculate ATC values based on data developed partially or totally by the RTO.⁶⁵ We also found that a single OASIS site for

⁶⁵Id. at 31,144-45.

each region, instead of multiple sites, would enable transactions to be carried out more efficiently.⁶⁶ However, we permitted flexibility in assigning OASIS responsibilities.⁶⁷

We find that assigning responsibility for OASIS to ISO-NE, and the division of responsibilities for calculating TTC and ATC between ISO-NE and NE ITC would be acceptable under Order No. 2000, assuming that both NE ITC and ISO-NE satisfy the independence criteria, discussed above. We will grant Dynegy's request that interconnection procedures and the status of interconnection requests be posted on OASIS. Interconnection is a part of transmission service, and thus should be posted on OASIS.

RTO Function No. 6: Market Monitoring

To ensure that the RTO provides reliable, efficient and not unduly discriminatory transmission service, the RTO must provide for objective monitoring of markets it operates or administers to identify market design flaws, market power abuses, and opportunities for efficiency improvements, and propose appropriate actions.

1. Petitioners' Proposal

Petitioners state that the RTO proposal would meet Order No. 2000's requirements because ISO-NE would continue its market monitoring functions granted under Market Rule 17,⁶⁸ and performance of these functions would be strengthened through the appointment of an independent market advisor to ISO-NE and the formation of a Joint Monitoring Committee (JMC) to focus on interregional market issues. Petitioners note that the market advisor for ISO-NE would report directly to its Board and, along with the market advisor to NYISO, would comprise and assist the JMC in its interregional market monitoring efforts. In addition, ISO-NE and NE ITC would periodically commission audits of their individual performances. Petitioners submit that there is no need to monitor ISO-NE's market participant involvement because ISO-NE is a non-profit organization with no

⁶⁶Id.

⁶⁷Id.

⁶⁸Petitioners state that under Market Rule 17, the market monitoring unit of ISO-NE monitors, and where necessary, mitigates the spot market behavior of generators, marketers, retail suppliers and integrated utilities. Stating that Market Rule 17 would be amended to include assessments of interactions between the operations of Petitioners and other markets in New England, Petitioners also note that modifications to Market Rule 17 are still underway. See Joint Petition at 69 (citing ISO's Report of Compliance at 5, filed under Docket No. ER00-368-000 (November 1, 2000)).

economic interests to assess. They note that ISO-NE currently files reports with the Commission and affected regulatory authorities on opportunities for efficiency improvement, market power abuses, and market design flaws pursuant to Market Rule 17. Petitioners further state that NE ITC has not made a decision on the form or responsibilities of a market monitoring unit at this time.

2. Responsive Pleadings

A number of Intervenor state that the RTO cannot act independently from their interest in market outcomes, and disapprove of allowing ISO-NE to perform the market monitoring function.⁶⁹ In support of this contention, Intervenor cite ISO-NE and NE ITC's role as market participants, in particular the role as a supplier of last resort of ancillary services, and the lack of a workably competitive market. In addition, several Intervenor specifically note that NE ITC requires an independent market monitoring unit (IMMU) since it is a "for-profit" organization with stronger incentives to favor its own interests. NSTAR argues that Petitioners' proposal would improperly exclude NE ITC from oversight by the market monitoring entity, and assert that NE ITC's activities must be monitored by Petitioners' market monitoring entity. Although Petitioners disclaim any interest in market outcomes and assert that the JMC would identify potential market abuse, some Intervenor maintain that the proposed RTO cannot act independently from market participants.⁷⁰

Several Intervenor favor a separate market monitoring unit that is independent of ISO-NE and NE ITC. They emphasize that only an independent market monitor can review and audit the performance of ISO-NE and NE ITC. Many of these Intervenor endorse, in whole or in part, the Competitive Markets' proposal to establish an IMMU. Competitive Markets claim that as a separate entity focused on market monitoring, the IMMU would be truly independent with the necessary expertise for effectively monitoring power markets without hindering the development of competitive markets.

⁶⁹Some Intervenor raise, as a threshold issue, the need for the Commission to give clear direction on its approach to monitoring and mitigating power by defining market power and how it should be measured, and who would develop criteria for potential market power abuse.

⁷⁰In addition to opposing Petitioners' proposal on independence grounds, some Intervenor cite insufficient detail and question the proposal's effectiveness. PG&E et al note that the proposal leaves the market monitoring function attached to ISO-NE, and is joined by Municipals in stating that the significant additional costs do not warrant the minor changes to be implemented.

In contrast to Competitive Markets' proposal, the NECPUC and Rhode Island place the market monitoring function within an independent regional markets board. Regardless of its specific structure, these Intervenor favor an independent unit with market monitoring and mitigation functions. While Municipals contend that the existing structure meets required RTO functions, Massachusetts DOER and TransCanada support the proposed creation of the market advisor and JMC.

In addition, NRG states the necessity of separating the market decision-making process from reliability and operations authority of ISO-NE. NRG claims that the proposed advisory governance process would not satisfy the independence criteria because of the "inherent tension between market issues and reliability issues" that would arise from ISO-NE having all the decision making authority over market issues. NRG states that a separate independent entity is needed to monitor the effects of ISO-NE's reliability-based decisions.

Finally, many Intervenor expect the IMM to monitor interregional markets as well as the activities of ISO-NE and NE ITC. Intervenor generally support or cite the Competitive Markets' plans to expand the IMM to the Northeast markets, while TransCanada supports the ISO's efforts to establish a cross-border entity through the creation of a joint task force on inter-control area market coordination with NYISO.

3. Answers

Petitioners state that a separate IMM would decrease the effectiveness and efficiency of market monitoring, and contend that the JMC would accomplish everything set forth in either Competitive Markets' or NECPUC's proposal, and achieve broader regional focus in a superior manner. They state that market advisors would have the areas of expertise sought by the Competitive Markets and NECPUC, and would maintain appropriate independence since they would report directly to the respective boards. Petitioners also claim that NRG's belief in separating market decisionmaking from reliability decisionmaking, is erroneously based on NRG's premise that reliability decisions and the market cannot affect each other.

4. Discussion

In Order No. 2000, we required market monitoring plans to be designed to ensure that there is objective information about the markets that the RTO operates or administers, and that these plans be a vehicle for proposing efficiency improvements and remedying

market design flaws.⁷¹ While ISO-NE currently has a market monitoring program in place under Market Rule 17, Petitioners have not stated how they would revise this plan to deal with such issues as congestion management or the activities of NE ITC. As such, while the current plan may form a good basis to conduct monitoring under the proposed RTO, we cannot conclude that it fully complies with Order No. 2000 without a further explanation of how it would deal with these changes. The market monitoring function should monitor for market abuses or market design flaws, whether related to the operation of ISO-NE or NE ITC. In order to ensure that these monitoring responsibilities are sufficiently comprehensive, we would need to review NE ITC's proposed tariff including a market monitoring function and its incentive rates proposal.

Regarding Intervenor's concerns regarding the independence of ISO-NE's market monitoring unit, we note that Order No. 2000 permits, but does not require, the market monitor to be outside of the RTO. The Commission has the statutory responsibility to ensure that public utilities selling in competitive bulk power markets do not engage in market power abuse and also to ensure that markets within the Commission's jurisdiction are free of design flaws and market power abuse. To that end, the Commission will expect to receive the reports and analyses of an RTO's market monitor at the same time they are submitted to the RTO.⁷² The Commission intends to work with the market monitor to ensure that markets are functional and free of abuse or design flaws.

RTO Function No. 7: Planning and Expansion

The RTO must be responsible for planning and for directing or arranging necessary transmission expansions, additions and upgrades that will enable it to provide efficient, reliable and non-discriminatory transmission service and coordinate such efforts with the appropriate state authorities. If the RTO is unable to satisfy this requirement when it commences operations, it must file with the Commission a plan with specified milestones that will ensure that it meets this requirement no later than three years after initial operation.

1. Petitioners' Proposal

Petitioners propose a planning and expansion process based on a cooperative relationship between ISO-NE and NE ITC. ISO-NE would lead the regional transmission needs assessment, which would be developed through a stakeholder process to allow all interested parties to participate. Once the needs assessment is developed, NE ITC

⁷¹Order No. 2000 at 31,156.

⁷²California Independent System Operator Corporation, 86 FERC ¶ 61,059 (1999).

would lead the development of options for additional transmission capability to meet regional needs. These options may include using the existing assets more efficiently and targeted capital investments. Petitioners state that NE ITC would take into account new generation, conservation, demand management, and merchant transmission projects, while developing a regional transmission facilities outlook. Once NE ITC issues the outlook, ISO-NE would examine whether the outlook adequately assessed other alternatives and whether it includes proposals submitted by market participants. Petitioners state that ISO-NE's review role would ensure that the outlook is not biased in favor of transmission solutions at the expense of generation or other market-based solutions. They state that NE ITC would arrange for the investment and construction of new transmission facilities.

2. Intervenors' Comments

Intervenors generally do not support the exclusive decisional role for planning and expansion given to NE ITC. Municipals emphasize that the proposed NE ITC is a monopolist that would have the incentive to maximize the profits of its delivery service, and not necessarily serve consumer interests or enhance market efficiency. PG&E et al express the concern that incentives to NE ITC would be biased toward transmission solutions. PG&E et al argue that Petitioners' proposed planning and expansion process would give NE ITC the ability and the incentive to favor its transmission profit interests over competitive generation projects, merchant transmission, or demand response alternatives. Enron notes that NE ITC must not be allowed to profit from an increase in the number of financial congestion rights issued; otherwise, NE ITC would have an incentive to manipulate prices in the energy market for the benefit of the transmission owners. NSTAR argues that, because Petitioners did not submit specific tariff proposals, it is premature to seriously consider the proposal. NSTAR contends that, when a tariff is proposed, it must provide for a cost allocation formula that will allow orderly system expansion and uniform system-wide rates.

3. Answers

In response to Intervenors' claim that NE ITC's decisions on transmission expansion investments may result in excess transmission, Petitioners emphasize that these decisions must receive both state siting authority and Commission ratemaking approval. In addition, any proposed projects would be subject to ISO-NE Board's review. Petitioners assert that they address the Commission's concerns regarding potential discrimination in the planning process because they allow transmission owners an opportunity to participate in the process; *i.e.*, once ISO-NE identifies a transmission system need, it would be announced to the market and open for anyone's response. As their proposal would incorporate an independent transmission company, Petitioners object to following the planning process adopted by PJM or other RTOs.

4. Discussion

The planning and expansion process, as outlined by Petitioners, would involve input from stakeholders and ISO-NE. Both NE ITC and ISO-NE would be independent of market participants. While Intervenor's argue that under NERTO, NE ITC would have an incentive to favor a transmission solution for a constraint over a merchant transmission project, new generation or load reduction solution, NE ITC states that it has had extensive discussions concerning potential pricing proposals that would provide incentives for increased transmission system efficiency, promote the efficient construction of new transmission facilities, and facilitate greater competition in the New England markets. We believe that a properly structured incentive rate proposal can provide the proper incentives to promote the competitive markets and address the Intervenor's concerns.

Finally, Petitioners have provided only an outline of how the transmission planning and expansion function would be handled under their proposed hybrid RTO. A detailed proposal should be consistent with our transmission planning principles, and should consider all market perspectives, identify expansions needed to support competition, and provide for input from all parties and for competitive solicitations for new projects. We share Intervenor's concerns about the potential for bias in planning. A remedy for this potential bias could be a properly structured incentive rates proposal. We reserve judgment on this issue until a more detailed planning and expansion proposal is made, which would embrace a larger scope.

RTO Function No. 8: Interregional Coordination

The RTO must ensure the integration of reliability practices within an interconnection and market interface practices among regions.

1. Petitioners' Proposal

Petitioners propose to participate in several initiatives designed to enhance coordination with the northeastern RTOs, particularly with the NYISO. They assert that collaborative efforts between ISO-NE and the NYISO (and in some instances, the Ontario IMO and PJM) have produced the following accomplishments: (i) initial implementation of reserve sharing between New York and New England; (ii) improved coordination of planning studies between ISO-NE and NYISO; (iii) a draft report concerning the creation of a seamless day ahead market for New York, New England and

Ontario; (iv) progress through the MOU process; (v) defining grid operations and planning needs for RTOs and ISOs;⁷³ and (vi) NPCC collaborative reliability efforts.⁷⁴

In addition, Petitioners note ISO-NE and the NYISO's agreement to establish a joint task force and commit financial resources to achieve these initiatives and those of the MOU process.

ISO-NE has identified the following priorities through Petitioners' stakeholder process: (i) working with transmission owners and NE ITC to conform transmission practices across New York and New England; (ii) continuing to institute the draft report noted above; (iii) conforming inter-control area timetables in real-time; (iv) expanding implementation of reserve sharing among New York, New England and other NPCC control areas; (v) developing uniform standards for new generation interconnections that have impacts in both control areas; (vi) developing research and development initiatives; and (vii) implementing, on an interim and long-term basis, a JMC for New York and New England. They explain that ISO-NE, NYISO, PJM, Ontario IMO, and market participants are actively participating in resolving interregional coordination issues through the MOU process, which Petitioners propose that NE ITC would join.⁷⁵

2. Intervenors' Comments

Several Intervenors contend that ISO-NE, the NYISO and PJM should be merged into a single Northeast RTO. Industrial Consumers urge the Commission to require that Petitioners, the NYISO and PJM commit within 90 days to address these seams issues by the RTO start-up date, or show cause why they should not be merged into a single Northeast RTO. Intervenors argue that there is real danger that if bold, interregional initiatives are not taken immediately, both the New England and New York market institutions will become

⁷³Petitioners cite an Electric Power Research Institute-sponsored RTO workshop at Holyoke, Massachusetts in October 2000 that discussed the issues noted above.

⁷⁴Petitioners point out that NPCC's proposal to conduct system-wide reviews to identify potential reliability impacts of projected changes in system facilities associated with each area's transmission plans would address Order No. 2000's directive regarding multi-area planning and the assessment of expansion plans.

⁷⁵Petitioners note that the MOU process is conducted by five working groups, each of which is comprised of representatives from each MOU participant and their respective market participants. They point out that the Operations Working Group has already facilitated the NYISO's and PJM's successful efforts to clarify their respective reserve responsibilities for inter-ISO transactions, which resulted in modifications to reserve procedures and eliminated a major obstacle to imports from Hydro-Quebec.

increasingly insular. NICC opposes ISO-NE's singular focus of converging its border with NYISO to the detriment of multilateral efforts to create a single Northeast energy market.

Certain Intervenorers oppose the convergence of ISO-NE, NYISO and PJM into one single Northeast RTO. For example, NECPUC urges the Commission to maintain the existing RTO boundaries, at least for the time being, to allow all stakeholders to focus their efforts on improving the current markets, while increasing their efforts to coordinate with adjoining regions. NECPUC argues that requiring a single Northeast RTO now would create yet another wave of institutional change and weaken the beneficial relationship between Northeastern ISO boundaries and the regional regulatory organizations that are concerned with operations within those boundaries. Additionally, NECPUC contends that it is premature to judge the MOU process as inadequate, although it is fair to argue that greater attention and urgency should be put into this effort. NECPUC states that it would welcome the Commission's active support to build upon the MOU process.

While several Intervenorers believe in and support the goals of the Northeast ISOs MOU process, they argue that the ISOs have yet to resolve significant regional energy market and reliability issues. Industrial Consumers request that the Commission convene a collaborative process because the MOU process has stalled. NRG contends that Petitioners' proposal to comply with the scope and interregional coordination requirement of Order No. 2000 through a continuation of the voluntary efforts such as the MOU process and other voluntary efforts is inadequate, should be rejected, and should be replaced with a more formal structure with timely status reports filed with the Commission to insure that the goals articulated in the joint petition are realized in a timely fashion. Although NICC applauds the MOU process and accomplishments to date, NICC argues that the process must be given greater attention by all market participants and all Northeast ISOs, if the process is to achieve its goal of eliminating all seams among Northeast energy markets.

Industrial Consumers contend that seams issues with other regions must be addressed, especially with the RTOs to the west. Aquila states that, with respect to ISO-NE and NYISO agreement establishing the task force to examine four issues, it should be noted that one of the issues on the list was to be completed by February 1, 2001; two issues are carry-overs from the MOU process (Day Ahead Market and interpool energy practices); and the fourth issue, which is new, deals with common minimum interconnection standards.

Several Intervenorers request staff involvement in the collaborative process utilizing the Commission's Dispute Resolution Service. Aquila requests that the Commission's Alternative Dispute Resolution (ADR) process be continued and expanded to assist in vetting the interregional and market issues. Dynegy contends that without aggressive

involvement by the Commission the MOU process will fail. Dynegy supports the use of the Commission's ADR service procedures, settlement judges and the technical staff of the Office of Markets, Tariffs and Rates. NRG and Aquila believe that the acceptance of Petitioners' proposal should be conditioned upon Petitioners' participation in the ADR process with the objective to develop a plan with specific milestones for the integration of the New England and New York markets, and to develop in the context of that plan a decision making process (e.g., ISO-NE would have complete and final authority with respect to the interconnection process for new generation interconnections).

3. Answers

Petitioners detail the progress made on the relevant initiatives such as uniform rules for a New York/New England/Ontario day-ahead market for energy transactions, implementation of reserve sharing protocols and an agreement for an additional 300 MW of reserve sharing for this summer. They also note that a longer term goal is to extend to other Northeast control areas a reserve-sharing arrangement through the efforts of the NPCC Control Performance Working Group.

4. Discussion

In Order No. 2000, we required an RTO to develop mechanisms to coordinate its activities with other regions, whether or not an RTO had been formed in those regions.⁷⁶ In addition, we stated that if it is not possible to coordinate mechanisms at the time an RTO proposal is filed, the RTO must propose reporting requirements, including a schedule, to provide follow-up details regarding how it is meeting the coordination requirements of this function.⁷⁷

ISO-NE's initiatives with the NYISO and NPCC to address market inefficiencies are a step in the right direction. However, as stated above, we believe that the scope and regional configuration of Petitioners' proposed RTO is too small and that the issues facing the Northeast would be better handled through an RTO that encompasses the entire Northeast region. As we note above, we are not satisfied with the parties' progress to date with respect to the MOU process and movement toward a single market for the Northeast.

⁷⁶Order No. 2000 at 31,167. Subsequently, in Order No. 2000-A, we stated that parties should utilize the collaborative process to discuss interregional coordination issues. Order No. 2000-A at 31,382.

⁷⁷Order No. 2000 at 31,167.

E. Incentive Rates

In Order No. 2000, we held that once RTOs are formed, performance based regulation (PBR) may be considered in order to facilitate good grid operation and to create incentives for RTOs to efficiently operate and invest in the transmission system.⁷⁸

Petitioners state in their filing that while they have addressed these issues in general terms, and plan to continue work on specific proposals for the Commission's consideration, a section 205 filing applicable to NE ITC is not anticipated until later this year. Petitioners commit that in advance of this filing, they intend to consult with stakeholders.⁷⁹ Petitioners outline their goals and general conceptual approach to PBRs and identify five issues that they believe must be addressed in any such filing: cost efficiency, transmission expansion, service quality, interconnection agreement schedule, and congestion reduction.

Under the PBR proposal to promote cost efficiencies, NE ITC would be motivated to reduce costs and increase efficiency to produce savings. This proposal may involve charges to customers for use of existing transmission assets fixed or tied to a widely recognized index for a certain period, except for limited re-openers for certain uncontrolled events such as storms and tax law changes. Regarding transmission expansion, options being considered to promote grid expansion include shorter depreciation lives and higher rates of return for new facilities. Proposals being considered to assure that service quality will not deteriorate in the pursuit of cost reductions include establishing penalties and rewards based on NE ITC's performance measured against certain benchmark levels reported to the Commission in an annual informational filing. The rewards or penalties would be reflected through changes to the charges paid by customers.

In order to expedite the interconnection process, Petitioners state that a PBR proposal currently under consideration would rely on a system of rewards or penalties for the completion of an interconnection study within a specified number of days once all necessary information is received from the customer. Petitioners state that a PBR proposal under consideration to promote a reduction in congestion would rely on NE ITC implementing a separate CMS that would be consistent with and complimentary with the CMS proposed by ISO-NE. NE ITC's CMS proposal could include rewards and penalties tied to forecasted measures of congestion.

⁷⁸Id. at 31,182.

⁷⁹As noted above, ISO-NE is not a sponsor of those portions of Petitioners' filing addressing rate proposals.

Although Petitioners have not included a specific incentive rate proposal in their filing, we encourage the parties and interested stakeholders to continue their efforts in this area and to consider the submission of such a proposal in the compliance filing required by this order.

F. Open Architecture

Petitioners state that their proposal contains no provisions that would limit the capability of NERTO to evolve and expand over time. Petitioners state that entry by new regional participants would be encouraged and that no inappropriate requirements would be imposed on entities seeking to join NE ITC. Petitioners further claim that the stakeholder process would be open to all and that NE ITC's structure would be sufficiently flexible to allow the geographic scope of NERTO to be expanded beyond the existing reach of ISO-NE. Finally, Petitioners state that under NERTO, ISO-NE would enhance coordination with other ISOs as the market conformance plan described in the filing moves forward.

In its protest, Competitive Markets emphasize the need for an RTO design that facilitates coordination and integration with other regions. Competitive Markets state that NE ITC and ISO-NE must have an architecture that is sufficiently open to accommodate innovation and changes in the institutions that comprise the competitive power markets in the larger region. Competitive Markets further state that the development of an ITC and the operations of ISO-NE must allow for and encourage integration with other regions such as New York, PJM, and Ontario, Canada.

Petitioners did not provide copies of their proposed tariffs, agreements and other governing contracts. Without these documents, we cannot make a finding on whether Petitioners comply with Order No. 2000 criteria for open architecture.

G. Petitioners' Authority to File RTO Tariff and Participation Agreements

Petitioners seek an order from the Commission confirming their right under Order No. 2000 and/or under the RNA, to make the necessary filings to establish NERTO. Petitioners note that as transmission owners who belong to a regional entity approved under Order No. 888, they are required under Order No. 2000 to propose arrangements to make their existing ISO comply with the Commission's RTO requirements. Petitioners contend that they have the necessary authority under the RNA to make such a filing. Petitioners cite to RNA Section 17A.3, for example, which provides that a transmission owner can terminate its relationship with ISO-NE in order to establish an alternative entity, such as an ITC. Under the RNA, Petitioners further claim that they can withdraw their facilities from the NEPOOL OATT in order to place those facilities under an ITC tariff.

Municipals dispute Petitioners' claimed authority to unilaterally revise the power pooling arrangements in New England and replace these arrangements with their proposed RTO. Municipals argue that Petitioners have neither the statutory nor contractual authority to implement their proposal to disconnect three fundamental features of NEPOOL's Order No. 888 compliance -the market provisions of Part Three of the RNA, the NEPOOL OATT, and the governance provisions of Part Two of the RNA. Citing the Commission's statement that individual pool members are not permitted to make section 205 filings revising the NEPOOL Agreement and NEPOOL OATT,⁸⁰ Municipals assert that the RNA does not permit unilateral amendment and that Petitioners do not justify their reliance upon Order No. 2000 as an independent authority for abrogating existing arrangements. Municipals allege that Petitioners are seeking to administer a new set of transmission arrangements that would be written without NEPOOL's decisional involvement. Municipals argue that Petitioners are acting in direct contradiction to ISO-NE's contractual obligations to NEPOOL.

We agree with Petitioners that section 17A.3 of the RNA gives each transmission owner the right to terminate or amend its relationship with the ISO "in connection with the creation of an alternative arrangement for the ownership and/or operation of its transmission facilities on an unbundled basis (e.g., a transmission company). . . ."⁸¹ Petitioners' proposal to form an RTO in compliance with Order No. 2000 is such an alternative arrangement. Section 21.2(a) of the RNA allows each transmission owner to withdraw its facilities from the NEPOOL OATT with six months' notice subject to the obligation to provide an alternative mechanism for provision of the services for three years. Accordingly, we find that the Petitioners are entitled to make appropriate filings to establish an RTO that will provide services now provided under the RNA.⁸²

H. NEPOOL

Petitioners seek an order from the Commission declaring NEPOOL's existing arrangements with ISO-NE and the New England transmission owners to be inconsistent with the requirements of Order No. 2000. For the reasons discussed above relating to independence and scope and regional configuration, we hereby grant Petitioners' request.

⁸⁰New England Power Pool, 91 FERC ¶ 61,227 (2000).

⁸¹Forty-Second Agreement Amending New England Power Pool Agreement, § 17A.3 (1999).

⁸²Petitioners would have to follow whatever procedures are required by contract to terminate, amend, or withdraw from the existing arrangements, and make any associated commission filings.

The Commission orders:

(A) Petitioners' request for a declaratory order seeking a determination that NERTO, as a hybrid transmission entity, satisfies the requirements of Order No. 2000, is hereby denied for the reasons discussed in this order.

(B) Petitioners' request for a declaratory order seeking a determination that the existing arrangements among NEPOOL, the New England TOs, and ISO-NE do not satisfy the requirements of Order No. 2000 is hereby granted for the reasons discussed in this order.

(C) Petitioners' request for a declaratory order seeking a determination that Petitioners have the authority to make the necessary filings to create NERTO is hereby granted for the reasons discussed in this order.

(D) The proceeding instituted by NSTAR in Docket No. RT01-94-000 is hereby terminated. NSTAR is granted the right to participate as an intervenor and protesting party in Docket No. RT01-86-000.

By the Commission. Commissioner Breathitt dissented in part with a separate statement attached.
Commissioner Wood concurred with a separate statement attached.

David P. Boergers,
Secretary.

Appendix

Intervenors

Docket No. RT01-86-000

American Forest & Paper Association (American Forest)*
Aquila Energy Marketing Corporation and Constellation Power Source, Inc.(Aquila)*
Associated Industries of Massachusetts & The Energy Consortium
BP Energy Company
Central Vermont Public Service Corporation, Citizens Communications Company and
Green Mountain Power Corporation (Vermont Utilities)*
Coalition for Competitive Markets (Competitive Markets)*
Connecticut Department of Public Utility Control**
Connecticut Office of the Attorney General**
Connecticut Office of Consumer Counsel**
Consumers of New England (Consumers)*
Duke Energy North America, LLC
Dynegy Inc. (Dynegy)*
Edison Mission Energy, Edison Mission Marketing & Trading Inc., and
Midwest Generation EME, LLC* **
Electric Power Research Institute (EPRI)*
Electric Power Supply Association (EPSA)*
El Paso Merchant Energy, L.P.
Enron Power Marketing, Inc. (Enron)* **
HQ Energy Services (US), Inc. (HQUS)*
Industrial Consumers of New England (Industrial Consumers)*
IRATE, Inc.*
Maine Public Utilities Commission*
Massachusetts Division of Energy Resources (Massachusetts DOER)*
Massachusetts Department of Telecommunications and Energy (Massachusetts DT&E)*
Massachusetts Municipal Wholesale Electric Company (Massachusetts Wholesale)
Massachusetts Office of the Attorney General **
Morgan Stanley Capital Group Inc. (Morgan Stanley)*
NEPOOL Industrial Customer Coalition (NICC)*
New England Conference of Public Utilities Commissioners (NECPUC)*
New England Power Pool Participants Committee
New England Publicly-Owned Entities (Municipals)*
New England Renewable Power Producers Association (NERPPA)*
New Hampshire Public Utilities Commission
New York Public Service Commission (New York Commission)*
NRG Marketing, Inc. (NRG)*

Ontario Independent Electricity Market Operator (Ontario IMO)**
Orion Power New York GP, Inc.
PG&E National Energy Group, Sithe New England Holdings, LLC; Power Development
Company, LLC; Mirant New England, LLC; Calpine Eastern Corporation; and Energy
Management, Inc. (PG&E, et al.)*
PPL Energy Plus, LLC*
Reliant Energy Power Generating, Inc.
Rhode Island Attorney General and the Rhode Island
Division of Public Utilities and Carriers (Rhode Island)* **
S.D. Warren Company*
Select Energy, Inc.*
Shell Energy Services Company, LLC (Shell)*
The Williams Companies (Williams)*
Tractabel Energy Marketing, Inc. & Tractabel Power, Inc.*
TransCanada Power Marketing Ltd. (TransCanada)* **
TransEnergie US, Ltd.*
Union of Concerned Scientists, Massachusetts
Public Interest Research Group, Massachusetts Energy Consumers
Alliance and the Clean Water Action of Massachusetts*
Unitil Power Corp., Fitchburg Gas and Electric Company, Concord Electric
Company, and Exeter & Hampton Electric Light Company
Vermont Department of Public Service

Docket No. RT01-94-000

American Forest & Paper Association
Aquila Energy Marketing Corporation and Constellation Power Source, Inc.*
Bangor Hydro-Electric Company, Central Maine
Power Company, National Grid USA, Northeast Utilities Service
Company, and The United Illuminating Company*
Connecticut Department of Public Utility Control
Dynergy Inc.
El Paso Merchant Energy, L.P.
Enron Power Marketing, Inc.
IRATE, Inc.*
ISO New England Inc.*
Massachusetts Department of Telecommunications and Energy*
Morgan Stanley Capital Group Inc.*
NEPOOL Industrial Customer Coalition*
New England Power Pool Participants Committee
New England Renewable Power Producers Association*
PG&E National Energy Group, Sithe New England

Holdings, LLC, Power Development Company, LLC, Mirant New
England LLC, Calpine Eastern Corporation and Energy
Management, Inc.*

S.D. Warren Company*

Sithe New England Holdings, LLC*

Unitil Power Corp., Fitchburg Gas and Electric Company, Concord Electric
Company, and Exeter & Hampton Electric Light Company

* parties filing protests or comments

** interventions out-of-time

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Bangor Hydro-Electric Company
Central Maine Power Company
National Grid USA
Northeast Utilities Service Company
The United Illuminating Company
Vermont Electric Power Company
ISO New England Inc.

Docket No. RT01-86-000

NSTAR Services Company

Docket No. RT01-94-000

(Issued July 12, 2001)

Breathitt, Commissioner, dissenting, in part:

Since the Commission began promoting RTOs as a means to remove barriers and impediments to wholesale electricity markets, I have been fully committed to the goal of implementing RTOs. However, I am dissenting, in part, to express my objections to specific language in this order and other RTO orders on today's agenda supporting the creation of four RTOs in the country. I agree with the majority's claim that the Commission has been attempting to facilitate the development of large RTOs reflecting natural markets since we issued Order No. 2000. That was our stated goal and one that I have actively pursued. However, today's orders go further by stating that the Commission "favors the development of one RTO for the Northeast, one RTO for the Midwest, one RTO for the Southeast, and one RTO for the West." I do not necessarily favor such development.

When the Commission deliberated over how to attain our mutual objective of RTO formation, we decided to adopt an open collaborative process that relied on voluntary regional participation. The intent was to design RTOs so that they could be tailored to the specific needs of each region. We specifically declined to propose fixed or specific regional boundaries under section 202(a) of the FPA. Instead, we concluded, as a matter of policy, that we would not attempt to draw boundaries, based upon our conviction that transmission owners, market participants, and regulators in a particular region have a better understanding of the dynamics of the transmission system in that region, and that they should propose the appropriate scope and regional configuration of an RTO. We did not specifically endorse one particular scheme of RTO configuration, but opted instead to establish appropriate guidelines to aid in RTO development. In fact, our regulation requires only that an appropriate region is one of sufficient scope and configuration to

permit an RTO to maintain reliability, effectively perform its required functions, and support efficient and non-discriminatory power markets.

Today's order represents a dramatic departure from the approach we pursued in Order No. 2000 to the extent that it directs the formation of four specific RTOs. Just as some commenters to our RTO rulemaking feared, the Magic Markers have come out, and the boundaries are being drawn with little regard to the status and timing of RTO formation efforts in various regions of the country. This was not my intent at the time we issued Order No. 2000; and the events since we issued Order No. 2000 do not compel me to embrace this policy shift. Parties have spent many hours and countless resources in negotiations, collaborations, and complicated business strategy sessions to develop reasonable RTO approaches. The impact of the majority's directive that these four RTOs be formed could be to render these efforts useless and force parties to begin the difficult and time-consuming process anew. For example, the Midwest ISO -Alliance settlement, which the Commission approved and which represented a tremendous effort by many parties, could unravel.

If the majority believes that the Commission should depart from the basic philosophies embodied in Order No. 2000, then I believe it would be only appropriate to initiate a formal notice-and-comment rulemaking proceeding so that we could make a reasoned decision informed by the views of the stakeholders in this process – state commissions, chief among others.

Finally, I do not adopt the majority's assertion that forming larger RTOs will result in lower wholesale electricity prices. This is a laudable goal, and as such, I embrace it. As a general proposition, Order No. 2000 encouraged the development of large RTOs. However, the promise of lower wholesale electricity prices is one that I, as a federal official, am not willing to make to consumers at this time.

For these reasons, I respectfully dissent.

Linda K. Breathitt
Commissioner

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Bangor Hydro-Electric Company
Central Maine Power Company
National Grid USA
Northeast Utilities Service Company
The United Illuminating Company
Vermont Electric Power Company
ISO New England Inc.

Docket No. RT01-86-000

NSTAR Services Company

Docket No. RT01-94-000

Wood, Commissioner, concurring:

(Issued July 12, 2001)

In the discussion of RTO Function No. 2, NERPPA observes that locational marginal pricing, at least as it is employed in New England, will make it more difficult for renewable generators to compete. The order dismisses this concern (in footnote 57) referring to an earlier holding that exempting renewable generators from congestion charges would place them at an advantage over other generators. As written, this statement may be true, but it misses the core point: we should not have congestion management schemes or any other processes that discriminate on the basis of technology in the first place. Renewable resources are an increasingly important part of our nation's energy mix. It doesn't make sense to penalize wind for intermittency limitations any more than we should penalize coal plants for their ramp rate limitations.

Of course, the best way to avoid this problem is to eliminate transmission congestion in the first place with proactive transmission planning, siting and construction. But I will write about that another day. For today, we must address congestion management. We should do so in a standard format nationally, and do so in a way that all generation technologies are treated fairly.

Respectfully submitted,

Pat Wood, III
Commissioner